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ACTION EA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

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FM AMEMBASSY TAIPEI

TO SECSTATE WASHDC 1746

AMCONSUL HONG KONG

INFO AMEMBASSY SEOUL

AMEMBASSY TOKYO

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HONG KONG FOR TREASURY REP

EO 11652 NA

TAGS ECON TW

SUBJECT: FIRST QUARTER PERFORMANCE ROC ECONOMY AND PROSPECTS
FOR REMAINDER OF YEAR

REF: TAIPEI 834, 607

1. BEGIN SUMMARY. ALTHOUGH FIRST QUARTER RESULTS CONFIRM SUB-
DUEDED ECONOMIC OUTLOOK, WE STILL CANNOT CONFIDENTLY PREDICT
ROC'S

OVERALL ECONOMIC PERFORMANCE IN 1974. AS RESULT OF STRONG ANTI-
INFLATIONARY MEASURES TAKEN BY GROC IN JANUARY MONEY SUPPLY HAS
DECREASED DRAMATICALLY, SAVINGS DEPOSITS HAVE INCREASED AND
WHOLESALE AND CONSUMER PRICES HAVE REMAINED RELATIVELY CONSTANT
SINCE FIRST OF MARCH. OTHER PROBLEMS HAVE EMERGED, HOWEVER,
WHICH COULD VITIATE GROC EFFORTS. TRADE BALANCE TURNED
NEGATIVE IN MARCH AND IS LIKELY TO REMAIN SO FOR REMAINDER

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OF YEAR. NUMEROUS BUSINESS FAILURES IN EXPORT

INDUSTRIES HAVE BEEN REPORTED RESULTING FROM DECLINE IN ORDERS AND UNAVAILABILITY COMMERCIAL LOANS. ANOTHER ROUND OF WAGE INCREASES IN PRIVATE SECTOR MAY BE STIMULATED BY GROC ANNOUNCED PLANS TO INCREASE SALARIES OF GOVERNMENT EMPLOYEES AND MILITARY JULY 1. PREMIER HAS ORDERED FULL-SCALE REVIEW OF ECONOMY BY ECONOMIC PLANNING COUNCIL (EPC). REPORT WILL BE CONSIDERED BY EXECUTIVE YUAN END OF MAY. EPC PROBABLY WILL CONFIRM ITS EARLIER PREDICTION THAT ECONOMY HAS BOTTOMED AND 7-8 PERCENT GROWTH RATE IN GNP STILL ATTAINABLE AND RECOMMEND THEREFORE FEW CHANGES IN ECONOMIC STABILIZATION PROGRAM OF JANUARY 26. END SUMMARY.

2. EMBASSY IS UNABLE TO PREDICT WITH ANY DEGREE OF CONFIDENCE LEVELS WHICH ROC ECONOMY WILL ATTAIN IN 1974. ECONOMIC STABILIZATION PROGRAM (ESP) ANNOUNCED JANUARY 26 HAS HELPED MODERATE SHARP INFLATION WHICH BEGAN TO PLAGUE ECONOMY IN 1973, PARTICULARLY DURING THE FOURTH QUARTER. MONEY SUPPLY DECLINED 7 PERCENT AND SAVINGS DEPOSITS INCREASED 1.5 PERCENT IN FEBRUARY OVER JANUARY AND IN MARCH MONEY SUPPLY DECLINED ANOTHER 4.3 PERCENT AND SAVINGS DEPOSITS ROSE AN ADDITIONAL 1.85 PERCENT. IN FEBRUARY WHOLESALE PRICES INCREASED 16.25 PERCENT AND CONSUMER PRICES 18.5 PERCENT OVER PREVIOUS MONTH AS MASSIVE INCREASES ANNOUNCED JANUARY 26 FOR FUEL, POWER AND TRANSPORTATION WENT INTO EFFECT. IN MARCH PRICES BEGAN TO LEVEL OFF AND FOR MONTH AS A WHOLE WHOLESALE PRICES DECLINED 1.1 PERCENT AND CONSUMER PRICES INCREASED ONLY .8 PERCENT COMPARED WITH PREVIOUS MONTH. SPOT CHECK IN APRIL FOR BOTH CATEGORIES INDICATE STABILIZING TREND IN PRICES IS CONTINUING.

3. FURTHER EVIDENCE THAT INFLATION HAS BEEN AT LEAST TEMPORARILY CHECKED CONTAINED IN GROC DECISIONS IN MARCH AND APRIL TO REMOVE EXPORT CONTROLS ON A NUMBER OF ITEMS AND PRICE CONTROLS ON ALL ITEMS EXCEPT THREE STILL IN SHORT SUPPLY; MONOSODIUM GLUTAMATE, TOILET TISSUE AND CEMENT. CONTROLS ON LATTER PROBABLY WILL BE LIFTED IN MAY. ACCORDING TO OFFICIALS IN MINISTRY OF ECONOMIC AFFAIRS, WHICH ADMINISTERS PRICE CONTROL PROGRAM, SUPPLIES OF ESSENTIAL CONSUMER GOODS ADEQUATE AND HOARDING PSYCHOLOGY APPEARS TO HAVE RUN ITS COURSE.

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4. WAGES ALSO HAVE STABILIZED. FOLLOWING GROC ANNOUNCEMENT IN JANUARY THAT IT WAS GRANTING IMMEDIATE ONE-SHOT 10 PERCENT INCREASE TO BUREAUCRACY AND MILITARY, WAGE INCREASES WERE ALSO DEMANDED IN PRIVATE SECTOR. EMPLOYERS WHO DEMURRED WERE THREATENED WITH SLOWDOWNS, WALKOUTS AND, IN FEW CASES, SABOTAGE OF EQUIPMENT. INCREASES USUALLY WERE 10-15 PERCENT, ALTHOUGH THERE ARE REPORTS THAT SOME FIRMS-

WHICH PROBABLY WERE PAYING BELOW SCALE-- GAVE INCREASES OF UP TO 40 PERCENT. DEMANDS FROM WORKERS APPARENTLY HAVE BEEN SATISFIED FOR THE PRESENT. MAJOR US FIRMS CONTACTED BY THE EMBASSY IN LATE APRIL REPORT LITTLE OR NOT AGITATION FOR ADDITIONAL WAGE INCREASES.

5. FAVORABLE AS THESE TRENDS ARE, THE ULTIMATE SUCCESS OF THE GROC'S ECONOMIC STABILIZATION MEASURES IS BY NO MEANS ASSURED. OTHER TREENDS HAVE EMERGED IN THE EARLY MONTHS OF 1974 WHICH, IF THEYCONTINUE, COULD NEGATE THE RESULTS OBTAINED SO FAR. THE MOST SIGNIFICANT OF THES TRENDS ARE AS FOLLOWS:

A. MARCH TRADE FIGURES BELIED THE PHENOMENAL GROWTH IN FOREIGN TRADE WHICH DISTINGUISHED THE ROC ECONOMY IN 1973 AND CONTINUED INTO 1974 FOR THE FIRST QUARTER TOTAL TRADE WAS US\$2,769.5 MILLION, UP 90.1 PERCENT OVER THE FIRST QUARTER OF 1973. FOR THE FIRST QUARTER AS A WHOLE, THERE WAS A FAVORABLE TRADE BALANCE OF US\$55.7 MILLION; HOWEVER, IN MARCH 1974, THE TRADE BALANCE WAS NEGATIVE, REACHING US\$54.2 MILLION.

WHILE THE VALUE OF EXPORTS INCREASED BY 69.2 PERCENT O(OVER MARCH 1973 THE VALUE OF IMPORTS INCREASEC BY 118.3 PERCENT,) DUE PRIMARILY TO INCREASED COSTS OF AGRICULTURAL AND INDUSTRIAL RAW MATERIALS, INCLUDING CRUDE OIL. SINCE THE VALUE OF IMPORT LICENSES AGAIN EXCEEDED THE VALUE OF EXPORT LICENSES IN DECEMBER 1973 AND EACH MONTH THEREAFTER THROUGH MARCH 1974 THE BOFT IS PREDICTING THAT THERE WILL BE AMONTHLY TRADE DEFICIT AT LEAST UNTIL AUGUST OF THIS YEAR. THE ROC TRADE SURPLUS WITH THE US, WHICH REACHED APPROXIMATELY US\$725 MILLION IN 1973, IS BEGINNING TO SHRINK. DRUING THE FIRST QUARTER OF 1974 IMPORTS FROM THE US WERE US\$363 MILLION, COMPARED BY US\$139 LIMITED OFFICIAL USE

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MILLION DURING THE SAME PERIOD IN 1973 (A 160 PERCENT INCREASE), WHILE EXPORTS TO THE US WERE US\$472 MILLION COMPARED WITH US \$313 MILLION LAST YEAR (A 50.8 PERCENT INCREASE). THE FIRST QUARTER TRADE SURPLUS WITH HTE US IN 1974 WAS US\$109 MILLION COMPARED WITH A SURPLUS OF US\$174 MILLION IN IN 1973.

B. NET FOREIGN EXCHANGE ASSETS OF THE ROC BANKIG SYSTEM HAVE DECLINED GURADULLY BUT CONSISTENTLY SINCE OCTOBER 1973 WHEN THEY PEAKED AT US\$1,931 MILLION. BETWEEN THE END OF NOVEMBER 1973 AND THE END OF FEBRUARY 1974 THEY DECLINED BETWEEN 1.5 AND 2 PERCENTAGE POINTS A MONTH. IN MARCH 1974 THE DECLINE WAS 3.8 PERCENT AND AT THE END OF THE MONTH ASSETS WERE US\$1,767 MILLION, A DECLINE OF US\$167 MILLION IN FVE MONTHS.

C. ON APRIL 18, 1974, THE BUREAU OF INDUSTRIAL DEVELOPMENT (BID) OF THE MINISTRY OF ECONOMIC AFFAIRS CONFIRMED THAT 438 FACTORIES HAD CEASED OPERATIONS DURING THE FIRST QUARTER OF THE YEAR. IN THE GARMENT INDUSTRY, 47 OF 280 FACTORIES (16.7 PERCENT) CLOSED; 23 OF 320 (7.2 PERCENT) KNITTING MILLS CLOSED; 48 OF 460 (10.4 PERCENT) WOOLEN MILLS CLOSED; 160 OF 285 (56.1 PERCENT) PLASTIC SHOE FACTORIES CLOSED AND 160 OF 645 (24.8 PERCENT) DECORATIVE LIGHT BULB FACTORIES CLOSED. WE HAVE FOUND ALMOST ALL ROC OFFICIALS MORE CONCERNED ABOUT THESE CLOSINGS THAN THEY WILL PUBLICLY ADMIT, EVEN THOUGH MOST OF THEM WERE SMALL AND INEFFICIENT WHICH COULD NOT COMPETE WHEN THE GOING GOT A LITTLE ROUGH.

6. THE ADVERSE TRENDS NOTED ABOVE POINT UP THE FACT THAT TWO OF THE ROC'S MAJOR EXPORT INDUSTRIES, TEXTILES AND PLASTICS PRODUCTS (PRIMARILY FOOTWEAR) ARE IN DIFFICULTIES.

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ACTION EA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

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FM AMEMBASSY TAIPEI

TO SECSTATE WASHDC 1747

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BECAUSE OF INCREASED COSTS RESULTING FROM HIGHER PRICES

FOR RAW MATERIALS AND UTILITIES, WAGE INCREASES, AND HIGH INTEREST RATES, PRICES ASKED BY ROC EXPORTERS HAVE RISEN SHARPLY. ORDERS ON HAND, PARTICULARLY FROM US BUYERS, ARE AT LOWEST LEVEL IN NUMBER OF YEARS AND LARGE INVENTORIES ARE COMMON.

7. EXPORTS OF ELECTRICAL MACHINERY AND SUPPLIES, SECOND MOST IMPORTANT EXPORT CATEGORY AFTER TEXTILES, MAINTAINED THROUGH MARCH RECORD PACE SET IN 1973. US ELECTRONICS MANUFACTURERS REPORT FACTORIES AT PRESENT OPERATING AT OR NEAR CAPACITY, BUT SECOND HALF PRODUCTION UNCERTAIN IF PRODUCTION COSTS INCREASE. EXPORTS OF PLYWOOD, WOOD PRODUCTS AND FURNITURE, THIRD MOST IMPORTANT EXPORT CATEGORY, RUNNING AT APPROXIMATELY 1973 LEVEL BUT TAIWAN PLYWOOD EXPORT TRADE ASSOCIATION AND TAIWAN LUMBER EXPORT ASSOCIATION REPORTS ORDERS ARE SLOW COMING IN FOR SECOND HALF OF 1974, AND TAIWAN TIMBER INDUSTRY ASSOCIATION REPORTS INCREASING DIFFICULTY IN OBTAINING LOGS WITH PRICES ALMOST DOUBLE A LIMITED OFFICIAL USE

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YEAR AGO. EXPORTS OF FIFTH MOST IMPORTANT CATEGORY, MACHINERY AND METAL PRODUCTS, HAVE DECLINED PRECIPITOUSLY SINCE BEGINNING OF YEAR. ACCORDING TO C. M. CHU, CHAIRMAN OF TAIWAN MACHINERY MANUFACTURERS ASSOCIATION, EXPORTS DURING PERIOD JANUARY-MARCH 1974 WERE 40 PERCENT OF EXPORTS DURING SAME PERIOD LAST YEAR. CHU ATTRIBUTES DECLINE TO WORSENEED MARKET CONDITIONS IN JAPAN AND WESTERN EUROPE AND INCREASING UNCOMPETITIVENESS OF ROC PRODUCTS IN WORLD MARKETS.

8. GROC IS JUSTIFIABLY CONCERNED AT SLUGGISHNESS OF EXPORT SECTOR, WHICH IN 1973 ACCOUNTED FOR 52 PERCENT OF GNP. PREMIER HAS REQUESTED ECONOMIC PLANNING COUNCIL (EPC) TO CONDUCT BY END OF MAY THOROUGH REVIEW OF ROC ECONOMY AND PRODUCE PERFORMANCE FOR REMAINDER OF YEAR. ACCORDING TO T. C. TSUI, SECRETARY-GENERAL OF EPC, REPORT WILL PROBABLY CONFIRM EARLIER EPC ANALYSIS THAT ECONOMY IS BASICALLY HEALTHY AND THAT GNP GROWTH OF 7.5 TO 8 PERCENT IS NOT UNREASONABLE IF GROC SOMEWHAT RELAXES TIGHT MONEY POLICIES AND PROVIDES INCENTIVES TO EXPORTERS. EPC WILL ALSO URGE GROC TO EXHORT MANUFACTURERS TO REDUCE PRICES WITH A VIEW OF STAYING IN MARKET WITH LOWER PROFIT MARGINS.

9. THERE ARE INDICATIONS, EVEN BEFORE EPC REPORT, THAT GROC IS PREPARING TO TAKE MEASURES TO PRIME ECONOMIC PUMP. ACCORDING TO OFFICIALS IN CENTRAL BANK OF CHINA, ANNUAL INTEREST RATE OF 17.5 PERCENT ON UNSECURED LOANS PROBABLY WILL BE LOWERED ONE OR TWO PERCENTAGE POINTS IN MAY WITH FURTHER REDUCTIONS, IF NECESSARY, TO FOLLOW GRADUALLY. EXECUTIVE YUAN ANNOUNCED MAY 4 THAT 11 PERCENT LOANS (DOWN

2 PERCENTAGE POINTS) WILL BE MADE AVAILABLE TO THOSE FORTUNATE
MANUFACTURERS AND EXPORTERS WHO HAVE RECEIVED LETTERS OF
CREDIT FROM OVERSEAS CUSTOMERS
AND FINANCIALLY DISTRESSED FIRMS WHICH RELY EXCLUSIVELY ON
EXPORT MARKETS MAY APPLY FOR GOVERNMENT LOANS TO TIDE
THEM OVER UNTIL EXPORT SITUATION IMPROVES. THE COST OF SUCH
LOANS HAS NOT BEEN ANNOUNCED BUT IT IS LIKELY TO BE 11
TO 12 PERCENT. THE MINISTRY OF ECONOMIC AFFAIRS HAS ANNOUNCED
THAT REBATES OF DUTIES ON IMPORTED PARTS AND SUPPLIES USED IN
MANUFACTURING GOODS FOR EXPORT WILL BE REINSTITUTED.
THAT MINISTRY ALSO HAS REQUESTED ALL GROC AGENCIES TO SCREEN
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IMPORT REQUIREMENTS CAREFULLY TO ENSURE THAT THE
NECESSARY FOREIGN EXCHANGE IS AVAILABLE FOR IMPORTS REQUIRED
TO SUPPORT THE EXPORT SECTOR.

10. THE POSITIONS OF THE EPC THAT THE ROC ECONOMY WILL PICK
UP SPEED IN THE SECOND HALF OF 1974 IS PREDICTED ON A STRONG
EXPORT PERFORMANCE AND THE EFFICACY OF CONTROLS DESIGNED TO
ENSURE THAT INFLATION DOES NOT GET OUT OF HAND.
THE CRYSTAL BALL IS STILL CLOUDY. WHILE EXPORT INCENTIVES MAY RESULT
IN ROC EXPORTS BECOMING MORE COMPETITIVE IN
WORLD MARKETS, THEY MUST BE ACCOMPANIED BY STRONGER MARKETING
EFFORTS, IMPROVED QUALITY CONTROL AND MORE RESPONSIVE MANAGEMENT.
AS A US CONSULTANT TO THE ROC TEXTILE INDUSTRY PUT IT WITHOUT
TOO MUCH EXAGGERATION: "THE TEXTILE INDUSTRY IN TAIWAN MUST
BE COMPLETELY RESTRUCTURED IF IT IS TO COMPETE IN WORLD MARKETS.
MANUFACTURERS BECAME FAT AND LAZY. ORDERS POURED IN WITHOUT

ANY EFFORT REQUIRED TO SELL BECAUSE PRICES WERE LOW. THOSE
DAYS ARE GONE FOREVER FOR TAIWAN." WHAT IS TRUE OF THE TEXTILE
INDUSTRY IS TRUE OF OTHER IMPORTANT EXPORT INDUSTRIES,
INCLUDING FOOTWEAR, PLASTIC PRODUCTS AND PROCESSED AGRICUL-
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